Supreme Court, U. S.
FILED
DEC 14 1977
MICHAEL RODAK, JR., CLERK

NO. 77-695

IN THE

Supreme Court of the United States

OCTOBER TERM, 1977

AMERICAN PUBLIC GAS ASSOCIATION, ET AL.,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

BRIEF OF RESPONDENT PRODUCERS IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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BRIEF OF RESPONDENT PRODUCERS IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

Pursuant to Rule 24 of the Rules of the Supreme Court of the United States, Amerada Hess Corporation, *et al.*,[1]

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parties to the case below, Conditional Cross-Petitioners in Case No. 77-697, and Respondents in Case No. 77-695, hereby submit their Brief In Opposition to the Petition for a Writ of Certiorari filed in Case No. 77-695 by the American Public Gas Association, *et al.*, (hereinafter referred to as "APGA") to review the opinions and orders entered by the United States Court of Appeals for the District of Columbia Circuit on June 16 and August 17, 1977 in the *Second National Natural Gas Rate Cases, American Public Gas Association, et al. v. Federal Power Commission,* Nos. 76-2000 *et al.*

STATEMENT OF POSITION

The petition filed by APGA raises questions relating to (a) the standard of judicial review utilized by the Court of Appeals below, (b) its affirmance of the Commission's[2] inclusion of a federal income tax component in the nationwide new natural gas rates, and (c) its affirmance of the Commission's use of a rulemaking procedure to determine such rates. We submit that the issues upon which these questions are based were properly considered by the Court of Appeals with the utmost care and extreme detail in an opinion exceeding 100 pages. The Court of Appeals decided these issues correctly; further review by this Court is not warranted.

Petroleum Company, Sun Oil Company (Delaware), The Superior Oil Company, Supron Energy Corporation (formerly Southern Union Production Company), Tenneco Oil Company, Texasgulf Inc., Texaco Inc., Texas Pacific Oil Company, Inc., Texas Production Company, Transocean Oil, Inc., and Union Oil Company of California [hereinafter referred to as "Producers"].

2. Federal Power Commission. By the Department of Energy Act, P.L. 95-91, 91 Stat. 565 (1977), the Federal Energy Regulatory Commission assumed all authority exercised previously by the Federal Power Commission relevant to the proceedings below.

REASONS FOR DENYING THE PETITION FOR A WRIT IN CASE NO. 77-695

I. The Court Of Appeals Applied The Standards Of Judicial Review Heretofore Prescribed By This Court.

The APGA contends that the Court of Appeals has changed the standards of review in its opinion below. This contention is simply not true. The Court of Appeals carefully reviewed the voluminous record and correctly applied the substantial evidence test on those points raised by the APGA.

The standards of review applicable to Commission ratemaking were first articulated by this Court in *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) and later reiterated and amplified in *Permian Basin Area Rate Cases*, 390 U.S. 747 at 767 (1968).

In *Permian*, this Court held that a "presumption of validity" attaches to each exercise of the Commission's expertise, and that those who would overturn the Court's judgment undertake "the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences." 390 U.S. at 767. Here, the Court of Appeals found that APGA failed to meet that burden in each instance.

More recently, this Court in *Mobil Oil Corp. v. FPC*, 417 U.S. 283 (1974), interpreted these standards as requiring the reviewing court to respect the agency's need to reconcile the diverse conflicting interests of the parties to such a proceeding, particularly in light of the "acute energy shortage" (417 U.S. at 331). Expressly adopting these standards of review, the Court of Appeals carefully

scrutinized the Commission's orders ". . . to assure itself that the Commission seriously sought answers and engaged in reasoned decision-making", (Appendix p. 23).[3] Thus, it is apparent that the Commission is given broad discretion to select modes of regulation and to determine just and reasonable rates which will not be overturned on review unless they lack support by substantial evidence as prescribed by this Court in *Mobil* and *Permian* or unless the Commission has exceeded or abused its authority.

Here the Court of Appeals found (Appendix pp. 92-93) that the Commission had dealt with the issues raised by the APGA and that the Commission's findings with respect to them were supported by substantial evidence in each instance.[4]

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3. Contrary to the contentions of the APGA (Pet. pp. 18-19), the Court of Appeals found that the use of the American Gas Association natural gas reserves data by the Commission was reasonable and supported by substantial evidence (Appendix, p. 62).

4. In the 20 months during which Docket No. RM75-14 was pending before the Commission, several sets of comments and reply comments were filed in response to various issues raised by the Commission's December 4, 1974 order instituting the proceeding. The principal evidentiary filings were made by all parties on or about May 30, 1975. Included in such initial comments were not only the "Joint Comments of Indicated Producer Respondents" containing the sworn statements of 15 expert witnesses testifying as to virtually every issue properly before the Commission, but also the comments of the United Distribution Companies which contained the detailed study of H. Zinder & Associates, Inc. on factors influencing wellhead prices of new natural gas supplies. Furthermore, rate recommendations and supporting evidence upon which the Commission explicitly relied were submitted by the Commission's Bureau of Natural Gas and Office of Economics. Additional comments were filed by the parties in response to Commission orders on June 13, June 16, August 14 and October 3, 1975 and April 23, 1976. Oral arguments were also presented by the parties, including the APGA.

Petitioners challenge to the equity powers of the Court of Appeals in reviewing Commission proceedings under the Natural Gas Act ignores existing Supreme Court precedent directly on point. (Pet. p. 16.) This Court in *Mobil* explicitly acknowledged the long-established equity powers of a court of appeals reviewing a Commission order pursuant to Section 19(b) of the Natural Gas Act. As stated by the Court:

> "This jurisdiction [under Section 19(b)] to review the orders of the Commission is vested in a court with equity powers." (417 U.S. at 311)

The APGA's casual disregard of this precedent demonstrates the total lack of foundation of the contention. The Court of Appeals exercised its equitable powers in reviewing Opinion Nos. 770 and 770-A. In so doing, it fully complied with the statutory mandate of Section 19(b) and the substantial evidence standards.

Mobil specifically instructs that the review of Commission decisions is primarily the function of the court of appeals, and:

> "'. . . [t]his Court will intervene only in what ought to be the rare instance when the standard appears to have been misapprehended or grossly misapplied.' Universal Camera Corp. v. NLRB, 340 U.S. 474, 491, 71 S.Ct. 456, 466, 95 L.Ed. 456 (1951)." (417 U.S. at 310)

The Court of Appeals painstakingly reviewed the Commission's orders utilizing the *Mobil* and *Permian* standards. Nothing further is required of this Court.

II. The Court Of Appeals Properly Affirmed The Commission's Inclusion Of A Federal Income Tax Component.

The Court of Appeals reviewed the Commission's change in policy regarding the inclusion of a tax component in the rate ultimately established. After reviewing the Commission's justification of its change of policy as well as of its computation of the tax component, the Court of Appeals rejected those same contentions here advanced, finding that:

> [W]here the agency had both meaningful reasons for changing its methodology and, as we develop more fully below, a logical explanation for the new approach it adopted, the law does not hold the agency fast to its prior policy. (Appendix p. 35)

Under the standards established in *Mobil,* there is nothing in this conclusion warranting this Court's review.

In light of the changes in the law occasioned by the Tax Reduction Act of 1975[5] which effectively repealed percentage depletion and foreign tax-credit spillovers for oil and gas producers,[6] the Court of Appeals reviewing Opinion No. 699-H[7] specifically allowed the Commission

5. Pub. L. No. 94-12, 89 Stat. 26 (1975).

6. These two allowances for oil and gas producers have served in the past as the principal predicate for refusing to allow an income tax component in establishing area rates. *E.g.*, FPC Opinion No. 546, 40 F.P.C. 530 (1968), *aff'd sub nom. Austral Oil Co. v. FPC*, 428 F.2d 407 (5th Cir.), *cert. denied*, 400 U.S. 950 (1970).

7. Just and Reasonable National Rates For Sales of Natural Gas From Wells Commenced On or After January 1, 1973, and New Dedications of Natural Gas To Interstate Commerce On or After January 1, 1973, Opinion No. 699, 51 F.P.C. 2262, *final order on reh'g*, Opinion No. 699-H, 52 F.P.C. 1604 (1974), *aff'd sub nom. Shell Oil Co. v. FPC*, 520 F.2d 1061 (1975), *reh'g denied*, 525 F.2d 1261 (5th Cir.), *cert. denied*, 426 U.S. 941 (1976).

to undertake a *de novo* review of the tax issue.[8] Based on the evidence submitted by producers and others on this issue,[9] and in light of the changes in law, the Commission undertook such a review and determined that an allowance for federal income taxes was now required. The Court of Appeals properly applied the appropriate standard for review for this change in policy[10] and properly affirmed the Commission.

Further, the Court of Appeals properly rejected the APGA's contention that only actual tax returns could provide substantial evidence for a tax component. Both the Commission and the Court of Appeals found that historical tax returns of producers would provide no useful information for ratemaking purposes (Appendix pp. 35-39). Citing its own precedent,[11] the Court of Appeals found that use of a predictive model was appropriate in this case and satisfied the substantial evidence test.

APGA further contends that the Commission's computation of the tax component, and the Court of Appeals'

8. 525 F.2d, *supra*, at 1263.

9. Contrary to the contentions of the APGA, producers submitted sworn evidence on the tax issue, as did the United Distribution Companies, another party to the proceeding. R.221 and related exhibits; R.667-742; 813-14; 1693-1715; 1883-96. The APGA submitted *no* evidence in rebuttal. Thus, the Commission did not improperly shift the burden of proof to consumers; the producers and other parties met the evidentiary burden of proof, as to which there was no refutation.

10. *Greater Boston TV Corp. v. FCC*, 444 F.2d 841 (D.C. Cir. 1970), *cert. denied*, 403 U.S. 923 (1971).

11. *City of Chicago v. FPC*, 444 F.2d 841 (D.C. Cir. 1970), *cert. denied*, 403 U.S. 923 (1971).

affirmance, violates this Court's decisions in the *United* cases.[12] But the Court of Appeals held that the Commission properly interpreted *United* as permitting it to segregate jurisdictional sales of natural gas for tax purposes and to calculate a tax component on that basis. The validity of this approach was underscored by the Court's finding, echoing that of the Commission, that:

> . . . the implausibility of net nonjurisdictional loss for the producers—at least in the absence of contrary evidence from the petitioners [APGA]—renders unnecessary any inquiry into savings from consolidated returns.[13]

Finally, the APGA contends that use of an economic model results in a hypothetical tax component, and that the Court of Appeals' affirmance of this component was arbitrary. The APGA's contention is without merit.

As recognized by this Court in *Permian*, all cost calculations in an area rate proceeding are necessarily to some extent hypothetical. Nor does the utilization of an economic model make the ultimate result derived from the model "hypothetical." Rather, if the proper inputs have been made, the ultimate result derived will be reflective of operating conditions. If experience reflects inaccuracies, then adjustments can be made.[14]

Far from the significant benefits allegedly accruing to the producer to the total detriment of the consumer, the Court of Appeals found:

12. *FPC v. United Gas Pipe Line Co.*, 396 U.S. 237 (1967), *on remand*, 388 F.2d 385 (5th Cir.), *rev'd & remanded*, 393 U.S. 71 (1968).

13. Appendix p. 42.

14. *Id.* at 49.

> The ultimate point is that the Commission's approach reflects a determination to be both comprehensive and fair. . . . The Commission's model is designed to give the producer full compensation for any tax payments and the consumer full benefit of any tax savings. It is a logical model, that takes into account all experience that is known and that can be reasonably anticipated. (Appendix p. 48)

In light of these findings, no further review by this Court is warranted.

III. The Power To Establish Rates By Rulemaking Has Been Affirmed By This Court.

The APGA's contention (Pet. pp. 24-30) that the Commission violated the standards of the Administrative Procedure Act (APA) in determining nationwide rates is directly in contradiction with the decisions of this Court in *United States v. Allegheny-Ludlum Steel Corp.*, 406 U.S. 742, 758 (1972), *United States v. Florida East Coast Rwy. Co.*, 410 U.S. 224 (1973) and *FPC v. Texaco*, 377 U.S. 33 (1964).[15]

In his opinion for the Court of Appeals on this issue, Judge Fahy properly concluded that the procedures utilized by the Commission below "went a step beyond" the minimum required by the APA and satisfied also the hearing requirement of the Natural Gas Act. (Appendix p.

15. The APGA has raised this identical issue unsuccessfully in several other cases. See, *e.g.*, *Phillips Petroleum v. FPC*, 475 F.2d 842 (10th Cir. 1973), *cert. denied, sub nom., Chevron Oil Co. v. FPC*, 414 U.S. 1146 (1974), and *Shell Oil Co. v. FPC*, 420 F.2d 1061 (5th Cir. 1975), *cert. denied sub nom., California Co. v. FPC*, 426 U.S. 941 (1976).

100). Tracing the development of the law with respect to the Commission's power to establish rates by rulemaking under both the Natural Gas Act and the APA (Appendix pp. 94-101), the Court of Appeals found this Court's decisions in *Allegheny-Ludlum*, *Florida East Coast Rwy.*, and *FPC v. Texaco*, to be dispositive of the issue. Further, contrary to the APGA's assertions (Pet. pp. 13-14, 24-30), the Court of Appeals found no conflict in its decision below with its prior decision in *Mobil Oil Corp. v. FPC*, 483 F.2d 1235 (1973) or, for that matter, with the decisions of other circuits in the *Phillips*[16] and *Shell*[17] cases. Rather, the Court of Appeals found such precedents consistent with its holding that the Commission is not bound to the formal procedures of Sections 556 and 557 of the APA.

The Court of Appeals below thoroughly considered the APGA's arguments and found that all procedural requirements of the Natural Gas Act and Administrative Procedure Act had been satisfied (Appendix p. 26). Accordingly, no review is required by this Court.

16. *Phillips Petroleum v. FPC*, *supra*, n. 15.

17. *Shell Oil Co. v. FPC*, *supra*, n. 15.

CONCLUSION

The petition for a writ of certiorari of the APGA should be denied.

Respectfully submitted,

December 15, 1977

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CERTIFICATE OF SERVICE

I hereby certify that I have this day served copies of this Brief of Respondent Producers in Opposition to Petition for a Writ of Certiorari in accordance with Rule 33 of the Supreme Court of the United States.

December 15, 1977
Houston, Texas

/s/ PAUL W. WRIGHT
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